

**Speaking points for Rail Merger Bills Committee on 14 November 2006**

Thank you Madam Chairman. Good afternoon honourable Members.

As I have mentioned in the past, the proposed merger is a delicate balance between the interests of a wide range of stakeholders including the travelling public, shareholders and staff. The proposed merger package, which was arrived at after 18 months of negotiation, has in my view, achieved this balance. In addition to a Fare reduction at the time of the merger, a key element of this deal is the Fare Adjustment Mechanism which has to balance the interests of MTR shareholders, who were assured at the time of IPO that MTR would retain the autonomy to set fares, with the interests of the travelling public who demand a high quality, safe and reliable railway service at a reasonable price.

**Direct Drive**

On 28 October 2006, members heard submissions which highlighted the importance that MTR shareholders attach to fare autonomy. To quote from the submission of Mr. David Webb:

“A huge selling point in MTRC's prospectus from 2000 was: '[MTRC] has autonomy to determine its own fares without any requirement to obtain the approval of Government or any other body.'”

It is essential that in moving away from fare autonomy to an adjustment mechanism a transparent, objective and predictable mechanism which is applied automatically be adopted to facilitate stable business decisions by MergeCo.

Professor Ridley of Imperial College, London supported this view. In his submission he stated

“The formula, by allowing an automatic annual adjustment, protects the interests of the workforce of the metro by providing income that can support fair wages, protects the legitimate interests of shareholders who receive a fair return on the capital they provide, protects the interests of taxpayers by giving strong management incentives to deliver efficiency, and protects the interests of the travelling public against unjustified fares increases.....Therefore, in order to facilitate stable business decisions by the metro to deliver sustained, long-term service quality, it is essential that the agreed formula for annual adjustments in fares is adopted automatically and in full.”

### **“Permitted Range”**

An issue which was widely discussed at the last meeting of the Bills Committee was the, so-called, “permitted range” allowed under the FAM. First and foremost, the FAM sets out the percentage by which the overall MergeCo fares will be adjusted, downwards or upwards every year. The flexibility to adjust individual fares within the “permitted range” is to allow MergeCo to respond to changes in a highly competitive public transport market. Hence it is important to remember that in exercising this limited flexibility to adjust individual fares, MergeCo will still have to comply with the overall fare adjustment rate determined by the formula. My colleague Eddie So will now explain further the operations of the flexibility allowed within the “permitted range”.